

From:	Avi Tiomkin <ATiomkin@atglobalcap.com>
To:	ehbarak <ehbarak1@gmail.com>
CC:	nili Priell <nilipr@013net.net>
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Following our conversation in the morning .

Denmark Cuts Rates to Record Lows as Zero Threshold Breached
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By Frances Schwartzkopf

July 5 (Bloomberg) -- Denmark's central bank cut its main borrowing costs to record lows and brought the rate it offers on certificates of deposit below zero, as policy makers test uncharted territory to fight a capital influx.

The benchmark lending rate was cut to 0.2 percent from 0.45 percent, while the deposit rate was reduced to minus 0.2 percent from 0.05 percent, Copenhagen-based Nationalbanken said in a statement today. The move followed a quarter of a percentage point cut in the European Central Bank's main rate to 0.75 percent. Nationalbanken doesn't hold scheduled meetings and only adjusts rates to defend the krone's peg to the euro.

"There's no experience of how negative deposit rates will affect the financial markets and the krone," Jacob Graven, chief economist at Sydbank A/S, said in a phone interview today before the decision was announced. "It's a sign of the strong Danish economy. This is good. The opposite situation would be far worse, if the central bank would have to hike rates to defend the krone. We have a luxury problem."

Denmark has stepped up its battle to prevent the krone from strengthening beyond its currency band as the nation's haven status attracts investors. Danske Bank A/S, the country's biggest lender, said last week it now has a risk scenario that envisages Denmark abandoning the peg should the cost of fighting currency appreciation grow too high. The bank doesn't view this as a likely outcome, it said.

ECB Deal

Denmark has an agreement with the ECB to let the krone swing no more than 2.25 percent from central rate of 7.46038, though it maintains a tighter band in practice. Denmark's foreign reserves climbed to a record high in June after the central bank tapped the currency market to weaken the krone. Reserves rose by 9.2 billion kroner last month to 511.6 billion kroner (\$85 billion), the central bank said on July 3.

The central bank's battle to curb the krone risks undermining a recovery in the banking industry from a burst real estate bubble. Low interest rates are making it "increasingly difficult, if not impossible" for banks to earn money on deposits, Thomas Hovard, head of credit research at Danske Bank A/S, said before the rate cut.

Denmark's banks, which had 186 billion kroner in deposits at the central bank as of yesterday, are struggling to emerge from a burst real estate bubble that has sent house prices plunging 25 percent since their 2007 peak. More than a dozen banks have failed since then and two thirds of the country's regional lenders reported losses last year, leaving the industry

reluctant to withdraw funds from safe central bank accounts and channel them into the economy.

Negative Yields

The central bank on July 3 issued two-year notes at a negative yield for the second time in as many weeks as investors gave up returns for the safety of the Nordic country's AAA rating. Denmark is among the dozen countries that still maintain top grades at Fitch Ratings, Moody's Investors Service, and Standard & Poor's.

The central bank's debt management department, which handles bond issuance on behalf of the government, last month raised its 2012 debt sale target by 33 percent to 100 billion kroner to take advantage of falling yields.

Mortgage rates have also fallen to record lows. That's failed to revive the housing market and prices hit a seven-year low in the first quarter as properties stayed on the market for a record number of days, the Association of Danish Mortgage Banks said June 20.

The government in May cut its budget deficit estimate for this year, and said the shortfall will shrink to 1.7 percent of gross domestic product next year, within the European Union's 3 percent threshold.

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--Editors: Tasneem Brogger, Christian Wienberg.

To contact the reporter on this story:

Frances Schwartzkopff in Copenhagen at +45-33-457-125 or

fschwartzkol@bloomberg.net

To contact the editor responsible for this story:

Tasneem Brogger at +45-33-45-71-30 or

tbrogger@bloomberg.net;

Christian Wienberg at +45-33-457-121 or

cwienberg@bloomberg.net



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